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BEFORE THE ARIZONA CORPORATION COMMISSION

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Arizona Corporation Commission
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AZ Corporation Commission
Director Of Utilities

IN THE MATTER OF ESCHELON TELECOM OF ARIZONA, INC. APPLICATION FOR A CERTIFICATE OF CONVENIENCE AND NECESSITY TO PROVIDE RESOLD AND FACILITIES-BASED LOCAL TELECOMMUNICATIONS SERVICES

DOCKET NO. T-03406A-99-0742

DECISION NO. 67674

ORDER

Open Meeting
March 8 and 9, 2005
Phoenix, Arizona

BY THE COMMISSION:

INTRODUCTION

On May 21, 2004, Eschelon Telecom of Arizona, Inc. ("Eschelon" or "Company" or "Applicant") filed a request to modify the performance bond requirement in Decision No. 62751, dated July 25, 2000, which granted Eschelon a Certificate of Convenience and Necessity ("CC&N") to provide facilities-based and resold local exchange and interexchange telecommunications services in Arizona. That Decision requires Eschelon to "...procure a performance bond equal to 120 days intrastate telecommunications revenue as well as any prepayments, advances, or deposits." Decision No. 62751 also states that "if in the future, Eschelon desires to discontinue the performance bond, it must file information with Staff that demonstrates Eschelon's financial viability."

According to Eschelon, application of the performance bond formula requires Eschelon to post a performance bond well in excess of two million dollars. Eschelon's bonding company requires Eschelon to secure the performance bond with cash. Therefore, Eschelon requests that the

Commission modify or eliminate the performance bond requirement in Decision No. 62751. If the entire performance bond requirement cannot be discontinued, Eschelon requests that its performance bond be capped at $135,000, plus an amount to cover customer deposits (less than $15,000 at this time).

FINDINGS OF FACT

1. In its filing to modify or eliminate the performance bond requirement, Eschelon provided the following information that detailed its efforts to comply with the performance bond requirement and increase the amount of its performance bond as follows:

a) In August of 2000, Eschelon submitted a performance bond of $67,000. At that time this amount was in compliance with Decision No. 62751.

b) Based on a "Utilities Division Policy" dated June 28, 2001, Eschelon increased its bond to $135,000.

c) In June of 2002, Commission Staff informed Eschelon that the Commission had received notification from Eschelon's bonding company that Eschelon's performance bond would be terminated.

d) Eschelon filed a request under Docket No. T-03406A-02-0759 to have the performance bond requirement waived or to have it capped. On March 31, 2003, Staff issued its report recommending that the performance bond be increased to $400,000. On April 30, 2004, Eschelon withdrew its filing and Docket No. T-03406A-02-0759 was administratively closed on May 13, 2004.

e) Eschelon searched for a replacement performance bond at reasonable cost, with reasonable terms and condition, as well as possible alternatives to a performance bond. Eschelon had no other alternative but to turn over 100 percent of the face value of the performance bond in cash, as collateral, and pay a three percent fee to secure a $160,000 performance bond. The amount was determined by adding the amount of customer deposits Eschelon held in Arizona to the $135,000 performance bond. Eschelon acknowledges that the performance bond of $160,000 did not comply with the required amount established in Decision No. 62751. Eschelon believes that the $160,000 bond was the best it could provide given the bond guaranty company's demand for all cash collateral. Eschelon submitted the performance bond to the Commission in October 2003.

f) Currently, Eschelon has an Arizona performance bond of $400,000. The $400,000 in cash is in an interest-bearing, fiduciary account, accruing interest for the bond guaranty company. This cash cannot be used by Eschelon to enhance its Arizona operations.

g) On May 7, 2004, Staff informed Eschelon that it was not in compliance with the minimum requirement to provide "... a performance bond equal to 120 days intrastate telecommunications revenue..."

h) Eschelon filed this request to modify or eliminate the performance bond language in Decision No. 62751 to correct its compliance deficiency.

2. In its Application, Eschelon stated that it understands and supports the Commission's desire to protect Arizona consumers. Eschelon believes the financial status and strength of telecommunications carriers appears to be the main concern cited for requiring performance bonds of new entrants and of carriers seeking to encumber their assets to secure additional financing. In granting Eschelon's CC&N, the Commission stated that Eschelon could be relieved of the need to provide a performance bond by filing information demonstrating its financial viability.

3. Eschelon submitted its consolidated, audited, year-end 2003 financial statements for Staff's review. According to Eschelon, the financial statements show solid growth and adequate cash flow to ensure that its Arizona customers' deposits and payments will not be threatened. Customers' deposits are held in a special bank account and not used for any other purpose. Also, Eschelon reports that it has total assets, net of depreciation, in Arizona of over $13 million. Eschelon claims that its financial viability provides protection for Arizona telecommunications customers.

4. Eschelon states that the Commission should consider the effect that the performance bond requirement has on competitive providers like Eschelon. A bond guaranty company provides, for a fee, the administration of losses claimed against a bond. Bonding companies have told Eschelon that regardless of Eschelon's proven performance, it must secure any bond administered with one hundred percent cash as collateral. This represents cash that cannot be used for any other purpose.

5. The positive growth in Eschelon's revenues has resulted in an increase in its required bond. Eschelon believes that the increased bond requirements are beyond its ability to meet and it is therefore unable to comply with Decision No. 62751. Eschelon indicated that any requirement that the performance bond be increased as it becomes more successful places an

additional burden on the Company and appears punitive in nature. This is especially true, the Company asserts, when certain competitors do not have comparable requirements. Eschelon stated that it understands the need to increase a performance bond for a company that has a record of causing problems for consumers or has no other interests or investments within the State of Arizona. Eschelon asserts that these concerns do not apply to it and Eschelon points out that it has an outstanding track record regarding customer service and responsiveness to the Commission's Consumer Services Section.

6. Eschelon informed Staff in its November 15, 2004 Supplement to the Application, that it serves small and medium-sized business customers in Arizona. It does not serve residential customers. In July 2004, it had approximately 4,100 voice telecommunications customers in Arizona.

7. Eschelon also stated that it has significant investments and assets within the State of Arizona. The Applicant states in its supplement that it has invested and continues to invest large amounts of capital in its facilities, including its switch in Phoenix. Its investment in Arizona exceeds $13.0 million.

8. Eschelon proposes the following:

a) Eschelon proposes that the Commission eliminate the performance bond requirement in its entirety due to the Eschelon's financial viability;

b) Should the Commission reject the first proposal, Eschelon proposes that it be allowed to maintain a performance bond of $135,000 plus an amount to cover customer deposits, which currently amount to approximately $15,000. In addition, it proposes to keep consumer complaints to the Commission at or less than 2 percent of its Arizona customer base per year. Complaints resulting from causes beyond Eschelon's reasonable control would be excluded from the 2 percent formula. Eschelon would increase its performance bond by $100,000 should it fail to meet this level of performance. Eschelon recognizes that the Commission would have the ability to increase the performance bond if indications of financial instability occur or evidence of issues that threaten service to customers surface.

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9. Staff obtained the following additional information from Eschelon in its responses to Staff's data requests:

a) Eschelon stated, in its response to Data Request JFB 1-13, that it bills its customers for local services one month in advance and that the total of local service monthly billing amounts to $915,000. Eschelon's billing provisions are included in its Arizona Tariff No. 2 in Section 2.5.2 on Page 28 and Arizona Tariff No. 3 in Section 2.6.1 on Page 15. Also, Eschelon reported, in response to Data Request JFB1-11, that there are no monthly charges to customers for special construction and equipment.

b) Eschelon collects deposits from certain of its retail customers in Arizona. The customer deposits in the amount of $10,878 are held in a special bank account as stated in its response to Data Request JFB 1-3 and Data Request JFB 1-24. Eschelon's deposit provisions are included in its Arizona Tariff No. 3, Section 2.3.1 at Page 13.

c) In its response to Data Request JFB 1-5, Eschelon indicated that it does not take or hold prepayments from its customers in Arizona. Eschelon does not offer prepaid calling cards as evidenced by its response to Data Request JFB 1-10.

d) According to Eschelon's response to Data Request JFB 1-6, Eschelon currently generates approximately $3.82 million of intrastate operating revenues in 120 days.

e) In order to comply with Decision No. 62571, Eschelon needs to cover the total amount of advances, deposits, and prepayments collected from its customers and 120 days of intrastate revenues. The aggregate of the deposits, local service monthly billings, and 120 days of revenue collected by Eschelon from its Arizona customers is approximately $4.8 million ($10,878+$915,000+$3.82million = $4,745,898 or $4.8 million rounded to the nearest hundred thousand).

f) Eschelon states that it has not been able to find a surety company that is willing to underwrite a performance bond without providing collateral of 100 percent cash. Eschelon acknowledges that some surety companies accept commercial real estate as collateral for performance bonds, but Eschelon does not have any investments in commercial buildings that could be pledged as collateral to obtain a performance bond.

g) An annual fee to purchase the performance bond is 3.1 percent of the face value of the performance bond or $144, 800 (3.1% X $4.8 = $144,800). In order to obtain the performance bond required in Decision No. 62751, Eschelon would have to provide $4.8 million in cash as collateral and pay an annual fee of $144,800. As a result, Eschelon would be required to put up over $4.9 million ($4.8 million + $144,800 = $4,944,800) in cash to secure a performance bond to cover the funds it collected from its Arizona

> customers. Eschelon would not have this cash available for use as working capital or capital to enhance or replace assets.

10. In Data Request JFB 1-23, Staff asked Eschelon to identify its competitors who were not required to post a performance bond. Eschelon provided a list of nine companies that it claimed were not required to obtain a performance bond. They are as follows: Allegiance, AT&T, Cox, Electric Lightwave (a subsidiary of Citizens), Mountain Telecom, Talk America, Winstar, Z-Tel and Nextlink/XO. Of the nine companies that Eschelon listed, AT&T, Cox and Electric Lightwave were not required to have a performance bond. The remaining companies were required to obtain a performance bond.

11. Staff identified the CC&N Decisions for companies whose tariffs were listed on the Commission website and for those companies reviewed the CC&N Decisions that could be retrieved from the Decision Database. The results of Staff's review are that 26.8 percent of the companies were required to have a performance bond and 28.3 percent of the companies were not required to obtain a performance bond. The remainder of the CC&Ns issued in the Decisions reviewed by Staff can be described as having been "Cancelled", "Revoked", "Transferred and Closed", or "Null & Void". All of the CC&N Decisions reviewed by Staff, except one, did not require the company to obtain a performance bond because the company provided resold long distance and did not take deposits from their customers. The noted exception was Decision No. 62672 relating to the acquisition of US West by Qwest and the sale of Teledistance to Touch America. Neither Qwest nor Touch America were required to have a performance bond. For all practical purposes, these findings indicate that the Commission's performance bond policy is being implemented in a uniform and consistent manner. Service providers of resold long distance services that do not collect advances, deposits and/or prepayments from their customers are not required to obtain a performance bond.

12. Staff reviewed the consolidated, audited, year-end 2003 financial statements furnished by Eschelon. The year-end 2003 financial statements showed that from December 31, 2002, to December 31, 2003, total assets decreased from $169.1 million to $153.7 million. Stockholders' equity eroded from $15.5 million as of December 31, 2002, to a negative equity of

$5.1 million as of December 31, 2003. Net income decreased from a positive $17.4 million as of December 31, 2002 to a loss of $ 20.6 million as of December 31, 2003. Based on these findings, Staff cannot conclude that Eschelon's financial situation is improving.

13. Utilities Division Consumer Services Staff reported that from January 1, 2002 through December 31, 2004, Eschelon had a total of two complaints in 2002, two complaints in 2003, and four complaints in 2004, a total of eight complaints. Among the eight complaints, two complaints pertained to billing issues, two complaints dealt with service issues, one complaint involved a disconnect, one customer complained about an outage, another customer complained about a carrier change, and one complaint addressed a miscellaneous issue. From January 1, 2002 through December 31, 2004, fifteen inquiries were received by the Commission from Eschelon's customers. Better than half of the inquiries received from Eschelon customers involved billing issues. Consumer Services Staff also reported that Eschelon is in "Good Standing" with the Corporations Division of the Commission.

14. On January 13, 2005, the Utilities Division Compliance and Enforcement Staff reported that Eschelon does not have delinquent items before the Commission.

15. If Eschelon were coming before the Commission today as a new entrant requesting a CC&N to provide facilities-based and resold local exchange and interexchange telecommunications services, it would be required to obtain a performance bond in the minimum amount of $235,000. In addition, the performance bond amount of $235,000 would need to be increased if at any time it would be insufficient to cover advances, deposits, and/or prepayments collected from Eschelon's customers. The performance bond amount would need to be increased in increments of $117,500. This increase would occur when the total amount of the advances, deposits, and prepayments came within $23,500 of the bond amount.

16. Staff believes that the performance bond alternatives proposed by Eschelon in its Application are not adequate.

17. On January 4, 2005, in Decision No. 67460, the Commission decided that XO Communications ("XO"), which serves only business customers and has a sizeable investment, $18.6 million, in Arizona maintain a performance bond of $235,000. XO is to increase the

performance bond if at any time it would be insufficient to cover advances, deposits and/or prepayments collected from its customers. The bond amount is to increase in increments of $117,500. The increase is to occur when the total of the advances, deposits and/or prepayments is within $11,500 of the bond amount.

18. Staff believes that Eschelon's situation is similar to XO's. Eschelon serves only business customers and has a sizable investment of $13.0 million in Arizona.

19. Staff recommends that Eschelon's bond requirement be changed. Staff recommends that Eschelon maintain a performance bond of $235,000. Eschelon should increase the performance bond if at any time it would be insufficient to cover advances, deposits and/or prepayments collected from its customers. The bond amount should be increased in increments of $117,500. The increase should occur when the total of the advances, deposits and/or prepayments is within $11,500 of the bond amount. These recommended performance bond requirements for Eschelon in this matter mirror those for XO that were approved in Decision No. 67460.

20. Staff understands that there is some controversy concerning the definition of "advances" with respect to bonding requirements. Staff has traditionally taken the position that advances included monthly service charges billed in advance ($915,000 in Eschelon's case.) Eschelon and other companies have taken the position that advances should not include monthly service charges billed in advance. Almost all providers of local exchange service bill their customers in advance (including Qwest and other ILECs.) For example, a customer's January bill is for February service (although it may not be actually paid until mid February.) The issue of the definition of advances, and other bond related issues, is currently being examined in a generic docket, Docket No. T-00000J-04-0912. Because the resolution of this issue in the generic docket will significantly impact Eschelon's bonding requirement, Staff recommends that while the generic docket is pending, the definition of "advances" for Eschelon's bonding requirement not include monthly service charges billed in advance.

CONCLUSIONS OF LAW

1. Eschelon is an Arizona public service corporation within the meaning of Article XV, Section 2, of the Arizona Constitution and A.R.S. § 40-285.

2. The Commission has jurisdiction over the subject matter in this proceeding.

3. The Commission, having reviewed the filing and Staff's Memorandum dated, February 17, 2005, concludes that it is in the public interest to approve this filing as conditioned by Staff's recommendation in Findings of Fact Nos. 19 and 20.

ORDER

IT THEREFORE IS ORDERED that the performance bond requirements for Eschelon be and hereby are amended.

IT IS FURTHER ORDERED that Eschelon shall procure and maintain a performance bond of $235,000. Eschelon shall increase the performance bond if at any time it would be insufficient to cover advances, deposits and/or prepayments collected from its customers. The bond amount shall increase in increments of $117,500. The increase shall occur when the total of the advances, deposits and/or prepayments is within $11,500 of the bond amount.

IT IS FURTHER ORDERED that while the Generic Docket on Bonding Requirement, Docket No. T-00000J-04-0912 is pending, the definition of "advances" for Eschelon's bonding requirement will not include monthly service charges billed in advance.

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IT IS FURTHER ORDERED that if Eschelon fails to docket and file proof of the procurement of a performance bond with Docket Control at the Arizona Corporation Commission within 30 days of the effective date of the Order of this matter, this Application shall be denied.

IT IS FURTHER ORDERED that this Order shall be effective immediately.

BY THE ORDER OF THE ARIZONA CORPORATION COMMISSION

Jeffrey Hatch-Miller

CHAIRMAN COMMISSIONER COMMISSIONER

Laurie Allen

COMMISSIONER COMMISSIONER

IN WITNESS WHEREOF, I BRIAN C. McNEIL, Executive Secretary of the Arizona Corporation Commission, have hereunto, set my hand and caused the official seal of this Commission to be affixed at the Capitol, in the City of Phoenix, this 9th day of March, 2005.

BRIAN C. McNEIL
Executive Secretary

DISSENT: ______________________

DISSENT: ______________________

EGJ:JFB:rdp/JMA

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DOCKET NO. T-03406A-99-0742

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